



California Tax Reform Association

717 K St, Ste 510, Sacramento, CA 95814

Ph: 916.446.4300 Fax: 916.444.6611

Email: info@caltaxreform.org

<http://www.caltaxreform.org>

Comments of the California Tax Reform Association on COTCE recommendations

With different proposals (1,2 and "blue") on the table, we offer these comments on the issues raised in these proposals.

1. The top personal income tax rate should not be lowered, since figures presented to the Commission demonstrate clearly that the volatility problem is a function of the distribution of income, not a steeply progressive tax. In fact, the tax is relatively flat, assessing the same marginal rate on the upper-middle class (90k +) as the very rich, with a very quick ride through the brackets. If anything, the bracket structure should reflect the federal structure, which has increasing brackets and rates at \$137,000, \$208,000, and \$372,000.

As Phil Spielberg's presentation on March 16 pointed out, the top 1% take an extraordinary share of income (25%), nearly doubling since the early 1990's. Their tax burden moves consistently with their share of income, so their disproportionate share of taxes is a function of their disproportionate share of income. That fact alone is what leads to volatility, but lowering their tax burden only exacerbates the mal-distribution of income. And any tax cuts share income with the federal government at a marginal rate of 35%, likely to become 39.6%, so are effectively a capital outflow.

Thus, we would urge rejection of both package 1 and 2 as providing significant relief to the wealthiest taxpayers, and further flattening an already relatively flat rate structure.

2. Any capital gains relief would be not only regressive but would reward a net outflow to the California economy. Part of capital gains volatility stems from the increased use of stock options in place of salaries, which would be rewarded further by any differential rate and is already incited by the federal tax structure. Capital investments are world-wide, and therefore capital gains relief has nothing to do with California investment; it would reward investment outside and inside the state equally. And the reduction provides major sharing with the federal government, at a 35% marginal rate, likely to become 39.6%.

Control of volatility should be an expenditure issue, not a tax issue (pt 9, below). The problem can be resolved by budgeting, not by tax cuts, as suggested in the "blue" proposal.

3. Net receipts for business is a concept worth examining, particularly as a substitute for the sales tax, by providing a very broad base for transactions. But a new approach to sales taxation which picks up electricity, gas, food, rental housing, internet services, and all other services, needs full exploration with regard to impacts, potential exemptions, and estimated revenue generation. We appreciate seeing for the first time a more fully articulated proposal for such a tax, posted on July 14. That proposal has a number of policy decisions within it which deserve close scrutiny with regard to potential impacts on both types of businesses and ordinary taxpayers.

We recommend that this concept be suggested for further study. Otherwise, we would expect that substantial variations in impacts could very well lead to a system full of exemptions and special provisions for different businesses and/or consumption items. The “blue” proposal suggests further study, and we concur. That would also imply rejection of package 1, which relies heavily on this untried and unstudied concept.

4. We support the “blue” proposal for reform of assessment of the non-residential property tax. As we have presented to the Commission, the current system is bad economics, bad law, bad fiscal policy and bad land use. Should the commission wish not to recommend constitutional changes, at minimum it should request the legislature to tighten change of ownership law for properties with complex holdings.

5. The Commission has failed to examine tax expenditures at any level of detail. It failed to explore the mis-placed tax breaks in the last budgets, particularly loss carry-backs, which are de-stabilizing for the tax system, and elective single sales factor, which allow for endless manipulation. It also failed to explore an oil severance tax, a proposal supported by the Governor, as an appropriate tax on economic rents as well.

In addition, a highly reputable academic study noted that California’s enterprise zone fails to create new jobs; the Legislative Analyst recommended the elimination of like-kind exchanges for commercial property. In short, there are easily billions in waste within the tax system which can pay for other tax improvements.

6. Carbon taxes appropriately tax pollution, not production, and the highly regressive impacts can be mitigated in a variety of ways—using 15% of the revenue, according to one study. In addition to fuels, carbon taxes on the electric sector can be recycled to ratepayers to pay for the costs of global warming and, with appropriately tiered rate structures which exist in California, need not fall regressively. If there were any tax appropriate to the challenges of the 21st century, one of the most significant of which is global warming, it would be a carbon tax, appropriately structured.

7. The corporation tax can and should be greatly improved. The last round of tax breaks made the corporation tax subject to extensive manipulation. Elective single-sales factor and loss carry-backs should be eliminated, and, on a revenue-neutral basis, could be replaced by a sales tax exemption for depreciable manufacturing equipment. Such a shift would reward new purchases and investment, rather than tax manipulation.

The corporation tax should be understood as a way that shareholders, many of them out-of-state, pay for the use of California resources. Corporations earn profits, distributed worldwide, from their California investments, and should pay for the use of California resources which create the environment they operate in.

In short, California’s corporation tax has been one of the best in the country until now, and should not be repealed; it should be reformed. The “blue” proposal suggests lowering the rate while repealing some, though not all, of the new loopholes. That would be an improvement, although that revenue, as suggested above, could be better used to eliminate the sales tax on depreciable manufacturing equipment.

8. We suggest the expansion of the sales tax base to a range of intangible commodities, including entertainment, storage, digital downloads, cable and satellite tv, hotels—in short, a variety of activities which are taxed in many states which do not otherwise broadly tax services per se.

However, even with the expansion of the tax to labor services, we do not believe that there is any credible proposal to end the sales taxation of business inputs, as proposed in the “blue” proposal. Many business inputs are end-use consumption items, and are just a cost of doing business which do not necessarily “pancake” into prices in a competitive market. And a wholesale exemption for business inputs creates significant enforcement issues which have never, to our knowledge, been put into practice in any state. Again, the exemption of sales tax on depreciable manufacturing equipment may be a relatively enforceable means of responding to this issue, paid for either as mentioned above or by expansion of the sales tax to intangible commodities.

9. Volatility is a budget/expenditure issue, not a tax issue. As noted above, the main reason for the volatility of the income tax is the concentration of income at the highest levels, where incomes are more volatility. Rather than reducing the taxation of the very wealthy, it makes sense to adopt budget control mechanisms which identify the level of extraordinary revenues in an upturn which should either be set aside or used in a one-time only manner, e.g. to pay down debt. We urge the commission to recommend budgetary controls as a means of living with the volatility which is inevitable when income is so mal-distributed. The “blue” proposal makes this recommendation.

10. On process: as we read Commission correspondence, we believe it is unfortunate that the only two packages appearing for consideration represent a very limited perspective on the charge to the Commission. Surely that is a function of the very short timeline that the Commission has had for major changes in the tax system. Thus, we believe it is very helpful that the “blue” proposal has been placed on the table as a point of reference for the options not explored. One possible recommendation of the Commission could be to establish a more systematic and in-depth process of examination of the tax system and potential for change.